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SENSITIVE

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TAGS: EINV ECON EFIN TU
SUBJECT: INVESTMENT ADVISORY COUNCIL PRAISES TURKEY'S PROGRESS BUT ASKS FOR MORE

REF: ANKARA 1728

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¶1. (SBU) Summary: Turkey's second annual Investment Advisory Council Meeting on April 29 in Istanbul brought recognition of the economic and political strides Turkey has made over the past year, including most notably macroeconomic stability and a date for beginning of accession negotiations with the EU. Participants also noted that progress had been registered on a number of the action items they identified last year, but stressed the urgency of further action, given the likelihood that the EU process will increase FDI flows to Turkey. In essence arguing that Turkey's macroeconomic progress should now be matched on the micro side, they urged tax reform to create a simpler and more stable tax regime, stronger corporate governance, continued reduction of administrative barriers, progress on privatization, and legal and social security reform, among others. With such actions, they predicted, FDI inflows will grow even more quickly than they have over the past year. As in 2004, the meeting attracted extensive interest from major multinational corporations, with a range of participants from European, Japanese, and American companies. End Summary.

¶2. (SBU) Multinational Giants: The April 29 conference brought together leading international CEOs, mostly from the European subsidiaries of major multinationals, with GOT economic decision-makers, including Prime Minister Erdogan, State Minister Babacan and others. The nineteen CEO's present at the conference represented firms from 11 countries with a total turnover of nearly 900 billion USD. Most already have extensive operations in Turkey. Sectors represented included finance (BNP Paribas, Citigroup, Unicredit), automotive (Daimler Chrysler, Fiat SpA, Ford, Hyundai and Toyota), and metals (Corus and Iscar). Other participants included Metro (retailing), Newmont Mining, Unilever, Siemens, and Pirelli-Telecom Italia. In addition to the foreign business invitees, President Rato of the IMF and Vice President Vorkink of the World Bank also participated. Attendance was rounded out by leading Turkish NGOs, including the Foreign Investors' Association (YASED), Union of Chambers and Commodity Exchanges of Turkey (TOBB), Exporters' Assembly (TIM), and Turkish Industrialists' and Businessmen's Association (TUSIAD). (Comment: Interestingly, the IAC is dominated by "old economy" companies, particularly automakers. The lack of "new economy" firms (software, pharmaceuticals, biotechnology, etc.) suggests some divergence between the corporate visions and priorities reflected in the IAC and many of those which are the subject of our bilateral commercial and economic advocacy, especially on intellectual property rights issues. End Comment.)

¶3. (SBU) Familiar Messages: As reflected in the communique issued at the end of the meeting, participants expressed high praise for Turkey's achievements over the past year, particularly in securing a date for the start of EU accession negotiations and in ensuring macroeconomic stability. They also noted progress in addressing some of the 13 priority areas they had identified last year (reftel). In particular, they cited government steps to reduce administrative barriers to investment, to encourage research and development by increasing incentives and government funding, to improve the supply chain for small and medium enterprises (SME), to invest in education and skill development, and not just to legislate but to implement legislation to protect intellectual property rights.

¶4. (SBU) Much to do: Notwithstanding these positive messages, the council also cited the increased urgency of tackling a broader range of issues, given the likelihood that increased investment will accompany the EU accession process. They reiterated a litany of issues that are also frequently cited by local corporations, pointing especially to the need for tax reform to create a simpler, more stable, and EU-consistent tax regime, the need for improved corporate governance, continued reduction of administrative barriers, "decisive" continuation of privatization, legal reform, energy sector liberalization, social security reform, continued R and D investment, and increased investment marketing efforts. They also urged the government not to use

the council as simply an annual action forcing event, but to take advantage of its expertise on an "ongoing basis."

¶5. (SBU) YASED Reacts: Among local participants in the meeting was the Foreign Investment Association (YASED), whose chairman, Saban Erdikler, offered a mostly upbeat assessment. In contrast to his past criticism of the government for its slowness in acting on the inaugural council's recommendations, he termed progress "satisfactory" and said he would give the government a passing grade of 6/10. He opined that foreign participants in the council would be even more generous. (Note: Other sources have been less charitable. One leading business paper failed the government, giving it a lackluster 4.8/10. End Note.) While conceding the need for extensive tax reform, he ascribed much of Turkey's image problem among potential investors to faulty information, arguing that while most perceive it to be more difficult to establish a company here than elsewhere in the OECD, actually it is easier. In a subsequent meeting, YASED Secretary General Mustafa Alper explained Erdikler's scoring

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rationale, conceding that 6 was on the high end, but arguing that a lower score would have shortchanged the government's "good faith" efforts, even if it would have accurately reflected continuing bureaucratic impediments to investment.

¶6. (U) Alper shared with Econoff YASED's own assessment of progress on the inaugural council's recommendations, which provides added detail to the second Council's own recommendations. Among the items singled out are the following, which were also highlighted (more positively) in a government report before the conference (reftel):

-- Administrative streamlining: Progress achieved in speeding up Environmental Impact Statements (EIS) and plans for "one-stop-shop" for municipal permits, but thus far with "limited" positive effect. Also stressed the need for simplification of procedures on sectoral issues.

-- Judicial System: Noted that further steps are needed to build on the "National Judiciary Network Project" and the new commercial code.

-- Tax Reform: Again judged the positive direct effect of improvements to have been limited, and argues that rates remain too high.

-- Customs Efficiency: Noted improvements, but presses for lower duties and simpler processes.

-- Land: Noted that many investors come up against difficulty in securing land with appropriate permissions for their planned projects. In addition, development plans are continuously altered, harming predictability.

Alper also noted that YASED and other NGOs will collaborate with the GOT in a follow-up mechanism designed to ensure that the councils lead to sustained progress in addressing the issues the companies identified and are not simply an annual extravaganza.

¶7. (SBU) Insider's View: Local representatives of participating companies generally expressed a positive view of the council and its outcome. Turan Aydin, a Turkish contact at Mitsui Corporation, whose European CEO Yasuo Hayashi participated in the council, noted that they had gone into the meeting with three principle complaints-- the difficulty of securing work permits for foreign workers in Turkey (Hayashi's admission he had illegal workers in his company as a result sparked extensive headlines), the weakness of corporate governance in Turkey, which has made it difficult for Mitsui to judge potential partners, and the Turkish environment's lack of administrative or regulatory predictability. Tax concessions or other privileges are often arbitrarily withdrawn after a short period, he noted, so that Mitsui has difficulty forecasting the environment it will face in the future. As a result, much more important than the provision of incentives is some sort of guarantee that what a company sees when it enters Turkey is what it will continue to experience for a predictable period. As an aside, Aydin noted that Hayashi had privately recommended to Prime Minister Erdogan that the government revisit its incentive schemes, perhaps by targeting particular areas for specific sectors.

¶8. (SBU) Comment: As with most such meetings, the Council offered a "feel good" opportunity for the government to tout its accomplishments, while also permitting participants to raise (privately) not just their general concerns but also the specific issues that have hampered their operations. It also marked the start of a concerted GOT public relations offensive on the economy, aimed at showcasing Turkey's newfound macroeconomic stability. By chance or design, the IAC was followed in quick succession by Istanbul's hosting of the annual Asian Development Bank (ADB) meeting, a visit by

German Chancellor Gerhard Schroeder and an enormous German business delegation, Forum Istanbul (an international gathering that assesses Turkey's prospects over the next 20 years) and the Turkish-Arab Economic Forum. With recent and prospective foreign investments in telecoms and other areas, Turkey is on track to garner as much as USD 8 billion in FDI this year, as much as the last several years combined.

¶9. (SBU) Comment continued: As the Council showed, much work remains to be accomplished in terms of structural reform, but for the first time in a generation Turkey has achieved macroeconomic conditions that have inspired foreign investors to take a second look. The potential problem is that the PM and others in the GOT will interpret high profile business accolades for the GOT's success in advancing the EU accession process and macroeconomic stability as an indication that investment climate and other structural reforms are no longer as urgent as they once were. End Comment.
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